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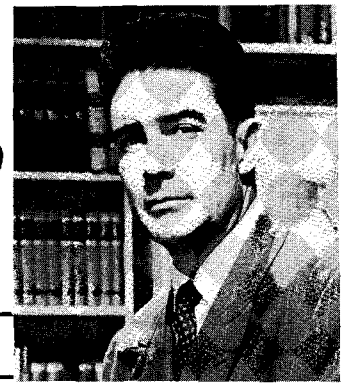

DAN SMOOT

DEFICIT FINANCING—PART I

On January 17, 1963, President Kennedy submitted his budget message, saying that he was recommending spending increases only in defense, space exploration, and interest on the national debt — but that he was reducing all other programs. Yet his message recommended enormous increases in the programs he said he was reducing.

In his "Tax Reduction and Reform" message of January 24, 1963, the President hammered the theme that the reductions and the reforms were inescapably tied together — that Congress must not approve reductions, without also approving reforms.

But on February 25, 1963, the President revealed that he is interested only in politically-popular tax-reduction. He said:

"Whatever is necessary to get that bill, I would support."

It is easy to see these obvious departures from truth in the President's budget-and-tax proposals. It is easy to see that quality of being a spoiled child, which is Kennedy's hallmark: he will do anything to get what he wants.

But we need some background to understand the "new principle" contained in the President's 1964 budget message — the principle of the *planned* deficit.

Roosevelt Years

On July 30, 1932, Franklin D. Roosevelt said:

"Revenues must cover expenditures by one means or another. Any government, like any family, can, for a year, spend a little more than it earns. But you know and I know that a continuation of that habit means the poor house." (1)

In every year of Roosevelt's administration, the federal government spent a great deal more than it collected in taxes. Here are the federal deficits for the 9 *peacetime* fiscal years of Franklin D. Roosevelt:

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1933	$ 2,602,000,000
1934	3,630,000,000
1935	2,791,000,000
1936	4,425,000,000
1937	2,777,000,000
1938	1,177,000,000
1939	3,862,000,000
1940	3,918,000,000
1941	6,159,000,000
Total	$31,341,000,000[2]

None of Roosevelt's deficits were "planned," however. Throughout, he maintained the pretense that he expected, or wanted, a balanced budget.

Roosevelt's peacetime deficit spending proved that government cannot spend a nation into prosperity. The spending (with the consequent governmental controls and meddling in the economy, and governmental favoritism to certain groups at the expense of other groups) was ostensibly intended to get the nation out of depression (which had been caused by governmental spending, meddling, and favoritism during and following World War I). Yet, the depression did not abate until our war economy began at the end of the 1930's.

American liberals have ignored this obvious lesson. Every President since Roosevelt has increased the federal debt, spending more money than the government had, borrowing from future generations, on the presumption that government spending would make the nation prosper.

Post War Years

Following World War II, President Truman (unable to spend as much as he desired on domestic programs) initiated the program of giving our wealth away to foreign nations, under the pretext of fighting communism. The more foreign aid we gave to fight communism, the faster communism grew — feeding on the aid we were giving.

This fact became so apparent that liberal leaders (while never admitting the fact) began to alter the pretext for foreign aid.

Into the foreign aid arguments there came the theme that giving aid was no drain on our economy — it was a stimulant which was good for our economy. Moreover, it was saving us money on defense, because it is cheaper to subsidize foreign armies to defend the world than it would be to defend the world with our own troops! This argument ignores the constitutional truth that the American government has no right or responsibility to defend the rest of the world, either with American troops or with subsidized foreign troops. It ignores the fact that our aid to build the defenses of the free world actually weakens those defenses, because recipient nations, instead of looking to their own defenses, tend to put their money into civilian spending, letting us carry most of the load for world-wide defense.

The American public could not forever be persuaded to accept this "defense" argument for foreign aid. Hence, there was another subtle alteration of argument: we are giving aid to other nations to make them prosperous enough to be good customers; we cannot remain prosperous if they do not buy from us; and they cannot buy from us unless we help them become prosperous. This is like saying that a neighborhood groceryman must give away money so that people in the neighborhood will have money to buy his groceries. The argument also ignores the fact that the real prosperity of America never was dependent on foreign trade, but resulted primarily from our great domestic market.

This foreign aid argument also wore thin. The European nations (given aid so that they could recover and become prosperous customers) did recover.

European (and Japanese) industries are largely free of the crushing weight of taxation imposed on American industries. They are free of the excessive labor costs which the favoritism of federal law and policy help monopolistic unions in the United States to impose on American industry. European (and Japanese) industries can obtain American raw materials

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(cotton, for example) at prices considerably below what American industries have to pay, because the American government subsidizes the cost for the foreign industries, and taxes Americans to help pay for the subsidy.

European (and Japanese) industries have new plants and facilities, built with tax money taken, in part, from American industries which cannot afford to modernize their own plants; and foreign industries have been given, without charge, techniques and special knowledge which American industry had developed at great cost, by trial and error, through the years.

With such advantages, Western European nations receiving our aid did indeed become prosperous; but they did not, as promised in the foreign aid arguments, become better customers for American goods. They found that they could buy goods cheaper elsewhere, because American goods were so burdened with tax-and-labor costs that they were priced above the world market. So, the nations which we helped to prosperity (and are still helping, despite their prosperity) increased their trade with each other, and started capturing not only America's traditional foreign markets, but also started making serious inroads into the American domestic market.

This condition became so apparent and so appalling that another alteration in the foreign aid argument became necessary. We are still aiding the advanced and prosperous nations, disguising the aid, for the most part, as "defense" or "mutual security" spending. We are still paying for much of the military defense of the prosperous nations; but we have de-emphasized "economic" aid to them.

Now, we are emphasizing economic aid to underdeveloped countries. The primary arguments for our aid to the underdeveloped nations are (1) that our aid helps to secure foreign sources of critical materials which America needs not only for prosperity but for survival; and (2) that our aid will help the underdeveloped nations to economic, political, and social stability and thus forestall their turning to communism.

These arguments ignore the fact that the United States could produce, within continental boundaries, the materials necessary in modern industry; and they ignore the fact that our aid, far from creating stability in the underdeveloped lands, is creating economic, political, and social chaos — and is actually financing the growth of socialism, which is a prerequisite preparation for communist conquest in the underdeveloped countries.

American Prosperity

Thus, the program of deficit spending to make the country prosperous has grown and developed since Roosevelt initiated the program as national policy in 1933. We did not become prosperous during the first eight years of the program.

For about one year prior to our entry into World War II, we did enjoy national prosperity, which resulted not so much because of spending by our own government, but because of artificial stimulation of American trade abroad.

There was enormous economic activity in the United States during the four years of our participation in World War II, but it is not accurate to say that we were nationally prosperous during that period. A civilian population unable to obtain luxury goods and severely restricted in its consumption of essential goods can hardly be called prosperous, regardless of how busy it is or of how much money is circulating.

Our real national prosperity began in 1946, after World War II. This prosperity, however, did not result from the spending of our federal government: it developed in spite of governmental spending.

In spite of governmental harassment and excessive taxation, American industry and American working men (with incredible inge-

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nuity and vigor) moved, after World War II, to supply the stored up demands of the American domestic market. The population expansion which followed World War II expanded the domestic market. The American economy, despite everything the socialist planners in Washington could contrive to do, had ten years of fabulous growth.

Decline Sets In

And then the reckoning! In the latter 1950's, our economic growth began to slow down. Even the American economy could not continue running at great speed, while carrying the enormous, ever-increasing burdens imposed on it by government. The marvelous American economy began to stagger under the load.

What staggered it most was the penetration, by American subsidized foreign industries, of our domestic market — the source of, and the key to, American prosperity.

Foreign producers, using production facilities and skills which our government had given them, began underselling Americans not only in world markets, but in the American market. For the first time in modern history, foreign producers of basic commodities like coal could undersell American producers in the American market. Ceramics plants and pottery factories in West Virginia went bankrupt because of foreign competition. Carpetmaking factories and textile mills in New England either went bankrupt or moved to southern states where right-to-work laws give workers and employers some protection against union bosses. Americans were even importing barbed wire (a commodity invented by Americans and, for a long time, produced almost exclusively in America).

By 1958, conditions had become so bad that politicians (whose programs had caused the conditions) grew shrill in demanding that something be done; but not one of them suggested stopping the governmental programs doing the damage. They suggested that we accelerate the harmful programs, but that we compensate the people and the areas thus harmed by giving them handouts from the federal treasury — handouts for urban renewal, public works, unemployment compensation, manpower retraining, school building, road construction, and so on.

Flight of Gold

A significant result of this relative decline in the American economy (decline, that is, in comparison with the growth of competing foreign economies) is the flight of our gold reserve to foreign nations — and the depreciation of American currency throughout the world. This is another condition which Roosevelt laid the basis for in the 1930's.

In May, 1933, Congress passed the Agricultural Adjustment Act, authorizing the President, among other things, to reduce the weight of the gold dollar which contained 25.8 grains of gold.

The announced purpose was to raise prices. If government could reduce the gold content, it could issue more dollars — which would not be worth as much as the old dollars. Hence, a merchant who had been charging $2.00 for a pair of shoes would have to charge more, because the dollars he accepted in exchange for the shoes had less purchasing power. The prices of all other commodities, and of labor, would have to go up accordingly and for the same reason. This would require the circulation of more money.

New Deal economists said this increased circulation of money would stimulate our economy. Yet, they knew that people would not willingly accept the cheapened currency; so they used the force of law. In the Agricultural Adjustment Act of 1933, which authorized the President to cheapen the dollar, there was a provision that all coins and currencies of the United States had to be accepted as legal tender, "dollar for dollar."

This meant that, if someone owed you 50 dollars, each of which had the value of 25.8 grains of gold, and he offered to pay you back

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with dollars that were not worth that much — you had to accept.

But government was still tied to the gold standard. There still had to be some fixed relation between the amount of gold reserve the government had and the amount of currency it could issue.

On January 30, 1934, Congress abolished gold coinage and our standard gold dollar. It became illegal for Americans even to possess gold coins, much less try to use them. The President promptly reduced the weight of the gold dollar from 25.8 grains to 15.24 grains — a reduction of 40 per cent in our standard of value.

This meant that Roosevelt, by one stroke, had confiscated 40% of the savings and investments of every person in the land. A man who had struggled and saved and denied himself for thirty years to lay aside $10,000 for his old-age retirement found that those dollars — in terms of what they would now buy for him — were worth only $6000.

Government could do this to its own citizens, because it could put them in prison if they resisted. But it could not do it to foreigners. So, ever since 1934, the United States government pays its obligations to its own citizens in whatever kind of currency it wants to issue, but foreigners can demand gold in exchange for the American dollars they hold.

A good history of this operation can be found in *Inflation in the United States*, a little book written by Paul Bakewell, Jr., and published in 1958 by The Caxton Printers, Ltd., Caldwell, Idaho. Price: $1.00.

Government took possession of the nation's gold and stored it at Fort Knox, and fixed its price at 35 dollars an ounce. The government sells the gold to industrial and medical users. It exchanges it for American currency which foreigners hold, when they demand exchange. And the government is required by law to keep in this gold reserve an amount equal in value (at $35.00 an ounce) to 25% of issued Federal Reserve currency. At present, this means that the law requires approximately 12 billion dollars to be held in our gold reserve as backing for our currency.

For many years, the special privilege of foreigners — to exchange their dollar holdings for gold — seemed to make little difference. Our economy was the strongest in the world. The American dollar was considered as good as gold, everywhere. Foreigners who got American dollars did not care to exchange them for gold, because, aware of the great strength of the American economy, they had as much confidence in American dollars as they had in gold.

But when foreigners begin to lose confidence in the American economy, they begin to lose confidence in our dollar. At that point, they are careful not to accumulate many American dollars. They present their American paper currency to the U.S. Treasury and demand gold in exchange.

Where do foreigners get American currency in the first place? From our government's aid and spending and lending programs abroad; from private American purchases overseas; from domestic American purchasing of foreign goods; and from American capital investments abroad.

By these means, we have been pouring vast quantities of American currency into foreign hands for many years. American spending abroad is, of course, offset by American selling abroad. Foreigners buy American goods, and spend their money in America.

The difference between this two-way flow of money is called our international balance of payments. If we spend more abroad than we sell, we have an unfavorable balance of payments situation: foreigners build up a surplus of American dollars, which they can exchange for the gold in our gold reserve. When such a condition persists for any length of time, we have a flight of our gold reserve to foreign lands.

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If foreigners can get enough surplus American currency to demand all of the gold in our reserve, and do demand it, America will then have a worthless currency, because it will have no backing. Foreigners will no longer accept American money because there will be no gold behind it. Wild inflation, with all its terrible consequences, will begin at that point.

By the mid-1950's, astute foreign investors noticed the relative decline in the overburdened American economy. Foreign industries were overtaking American industries in productivity and sales. The difference between the strained American economy and the economies of nations we were aiding began to level off fast. Other nations were outpacing us in economic growth; some were on the verge of surpassing us in actual economic strength.

The foreign investors (previously content to keep their American dollars and their holdings of other American securities) began selling them, and taking gold out of the U.S. reserve.

By 1958, this flight of the American gold reserve had become so alarming and conspicuous that mention of it began to appear in financial columns of the nation's press — though governmental officials never acknowledged the condition.

On September 23, 1958, Sam Dawson, financial columnist for the Associated Press, mentioned the sharp drop in Amrecia's gold reserve; but he expressed optimism. He said the flight of our gold had stopped and that we still had a 21 billion dollar reserve which, he said, was enough to meet all foreign claims and to back our currency.

Mr. Dawson was a bad prophet. Since 1958, an additional 6 billion, 802 million, 484 thousand, 879 dollars ($6,802,484,879.00) worth of our gold reserve has passed into foreign hands.

On January 9, 1963, our total gold reserve was 15 billion, 978 million, 113 thousand, 685 dollars ($15,978,113,685.00).

Law requires that 12 billion of the gold reserve be kept as backing for American currency. This left, on January 9, 1963, approximately 4 billion dollars in our gold reserve to meet all foreign claims. On that date, estimated foreign claims on our gold reserve (which could be presented as demands at any moment) totaled 21 billion, 600 million dollars ($21,600,000,000.00).[3]

In other words, America, at the beginning of 1963, was already at the mercy of foreign investors and foreign governments. We did not actually own any of the gold reserve at Fort Knox. Foreigners had more than 21 billion dollars worth of claims against the 4 billion dollars of reserve which we held to meet their claims; and their claims against our gold were increasing at the rate of 900 million dollars a year.

If these foreigners should suddenly sell their American holdings and demand payment in gold (as a result of some development which caused them to lose faith completely in the American economy) we would be bankrupt. The resulting panic would be more terrible than anything the world has ever seen.

With the great, colorful bubble of "prosperity" punctured, America, almost overnight, could become an impoverished land of closed factories, unemployment, and worthless currency; and it lies within the power of foreigners to do the puncturing.

That was the precarious condition of the economy of the United States on January 17, 1963, when President Kennedy submitted the most stupefying budget in the history of the world — a budget which, if adopted, could precipitate the final rush on our gold reserve.

Khrushchev Is Waiting

On January 17, 1963, U. S. Representative Clarence Cannon, Chairman of the House Appropriations Committee, stood in the House to comment on President Kennedy's budget message. Representative Cannon, a Democrat from Missouri, is a new-fair dealer with an old and earned reputation as a liberal spender of public money, a man who on many occasions

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has extended himself to defend the legend of the late great spender Franklin D. Roosevelt; a man who says he has the "highest affection and the warmest regard" for President Kennedy. Yet Cannon dramatically revealed that Kennedy was distorting fact when alleging, in his budget message, that non-defense spending is being held back. Cannon said:

"I have listened to messages from Presidents here in the House for 40 years, but in all that time I have never seen or heard a budget message like this one, and neither have you; nor has anyone else.

"This budget is the recordbreaker. . . . It proposes to spend $98,802,000,000. That tops the peak of World War II spending by $500,000,000 when the sky was the limit and survival the sole object.

"Only once before — in fiscal 1959 — has the budget in peacetime exceeded the $11,902,000,000 deficit shown in this budget. And impressions to the contrary, more than $6,600,000,000 of that tentative deficit figure cannot be ascribed to loss through tax cuts or revisions or national defense spending increases. Nor will rising space and interest expenditures account for it. Nondefense spending beyond available revenues is heavily involved. . . .

"The deficit estimate of $11,902,000,000 for 1964, following as it does an $8,811,000,000 deficit in the current year, and a $6,378,000,000 deficit in fiscal 1962, would add to the staggering sum of $27,091,000,000 of red-ink spending in 3 years. And that follows deficits of $21,953,000,000 in the previous 8 years for the shocking total of $49,044,000,000 since the war ended in Korea.

"Ah, but you say we have had to defend the country. . . . Let me cite a few figures taken from the budgets.

"This 1964 budget proposes spending of $4,491 million above 1963 — and $2,062 million of the increase is for other than national defense, a 5-percent increase.

"This 1964 budget proposes spending of $17,287 million above 1961 — and $9,348 million of the increase is for other than national defense, a 27-percent increase.

"This 1964 budget proposes spending of $31,265 million above the year following Korea, fiscal year 1954 — and $22,818 million of the increase is for other than national defense, an increase of 111-percent for nondefense, as contrasted with 18-percent increase for national defense items. . . .

"It is beyond dispute that we have been spending more and more and more for nondefense things and loading the cost onto future generations. . . .

"With these ever-increasing deficits and debts and decline in the value of the dollar, who is to say that European bankers, holding more claims against our shrunken and dwindling gold supply, will not resume their demands of the last 5 years when $6,802,000,000 in gold left Fort Knox? Since we convened here on the floor a year ago, our gold supply has dropped $910,000,000.

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"Since we convened here a year ago, the purchasing power of the dollar fell to a new low. Savings, pensions, life insurance, bonds will buy less.

"Since we convened here a year ago, the cost-of-living price index hit a new high 6 times. . . .

"Khrushchev is waiting. . . .

"Our Government — any government — . . . cannot spend and continue to spend more than they take in without inviting disaster. . . .

"It is the ever-rising nondefense items that have unbalanced the budgets of the last 10 years. . . .

"And in the budget today, with its hundreds of requests for increased appropriations — at a cost beyond what they can expect to take in — there are no reassuring signs of any disposition to reverse the trend. . . .

"And no provision for unforseen national emergencies. . . .

"How long will foreign bankers defer cashing in more of our dollars for gold as they watch us pile up more and more debt? . . .

"I include pertinent data on our dwindling gold supply. We have lost nearly $7,000,000,000 of our reserves since January 1958.

"Our supply is now just below $16,000,000,000.

"All but $4,200,000,000 is earmarked as backing for our money supply on a 25-percent basis.

"There are possible foreign claims outstanding of $21,600,000,000.

"That leaves a potential shortage . . . of $17,400,000,000 after allowing for the 25-percent backing.

"If we insist on further cheapening our dollar it would, manifestly, be absurd to delude ourselves into thinking foreign nations would sit idly by holding our dollars and securities when all they have to do is demand gold . . . .

"Undoubtedly the people would demand that we practice some restraint if they were but harshly aware of what they are paying Uncle Sam each week or each month in income taxes. The withholding tax system was devised to accelerate and facilitate collection of revenues to help finance World War II. And while it undoubtedly still serves to facilitate collections it sedates the people. It is painless. It mitigates the consciousness of tax burden. It caters to the illusion that money in Washington is free for the asking. That the Treasury is a bottomless resource with a boundless supply of dollars. I am not so certain but that revision of the system would be decidedly in the public interest. The people would demand an accounting if they were fully and painfully conscious of the tax bite, if periodically they had to draw a check or money order in favor of Uncle Sam and mail it to Washington."(3)

Next Week

We will discuss the "new principle" involved in the President's Planned Deficit.

FOOTNOTES

(1) *American Standard*, October, 1962
(2) "Summary of Federal Fiscal Operations," *Facts and Figures on Government Finance* (Copyright: Tax Foundation, Inc., 1961), 1960-1961 edition, p. 75
(3) "The President's Budget and Message," speech by U.S. Representative Clarence Cannon (Democrat, Missouri), *Congressional Record*, January 17, 1963, pp. 508 ff.

WHO IS DAN SMOOT?

Dan Smoot was born in Missouri. Reared in Texas, he attended SMU in Dallas, taking BA and MA degrees from that university in 1938 and 1940.

In 1941, he joined the faculty at Harvard as a Teaching Fellow in English, doing graduate work for the degree of Doctor of Philosophy in the field of American Civilization.

In 1942, he took leave of absence from Harvard in order to join the FBI. At the close of the war, he stayed in the FBI, rather than return to Harvard.

He worked as an FBI Agent in all parts of the nation, handling all kinds of assignments. But for three and a half years, he worked exclusively on communist investigations in the industrial midwest. For two years following that, he was on FBI headquarters staff in Washington, as an Administrative Assistant to J. Edgar Hoover.

After nine and a half years in the FBI, Smoot resigned to help start the Facts Forum movement in Dallas. As the radio and television commentator for Facts Forum, Smoot, for almost four years spoke to a national audience giving both sides of great controversial issues.

In July, 1955, he resigned and started his own independent program, in order to give only one side — the side that uses fundamental American principles as a yardstick for measuring all important issues.

If you believe that Dan Smoot is providing effective tools for those who want to think and talk and write on the side of freedom, you can help immensely by subscribing, and encouraging others to subscribe, to *The Dan Smoot Report.*

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